

Market Update for April 2010

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With the exception of the US, global share markets largely reversed last month's strong gains amid concerns that the debt issues facing Greece have begun to spread to other European nations. Bond yields were mixed and oil prices continued to strengthen on US dollar weakness and optimism that the US recovery will be sustained. Meanwhile, the Australian share market fell as a result of the knock-on effect of weaker European markets and increasing expectations of higher interest rates in China.

At a glance

- Global share markets mostly lower
- Oil prices continue to strengthen
- The Reserve Bank of Australia adds a further 0.25% to the official cash rate

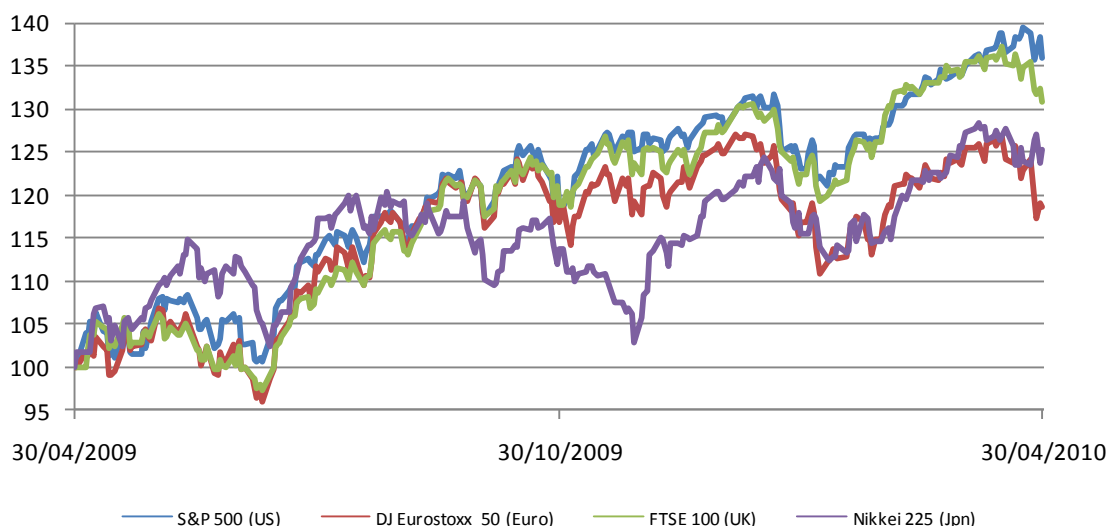
Global shares mostly lower

Global share markets were mostly lower in April, with losses in Europe (-3.9%), the UK (-2.2%) and Japan (-0.3%) countered by a relatively strong gain in the US (+1.5%). Headlines throughout the month were dominated by doubts over Greece's ability to repay its debt and whether or not other European nations will be similarly affected, namely Portugal and Spain. The big news, though, came later in the month, when Standard & Poor's (S&P) cut Greece's credit rating to 'junk'; the first time any euro member has lost its investment grade since the currency's debut back in 1999.

Greece was lowered to BB+ from BBB+ by S&P, which also warned that existing bondholders could recover as little as 30% of their initial investment if the country is forced to restructure its debt. The move, which puts Greek debt on a par with bonds issued by Azerbaijan and Egypt, came just minutes after the ratings company lowered Portugal from A+ to A-.

Unfortunately, all the bad news in Europe offset some very good news in the US, where company earnings for the March quarter consistently beat analysts' expectations, providing further evidence that the recovery there will continue and boosting investor sentiment.

Global share market performance - Year to 30 April 2010

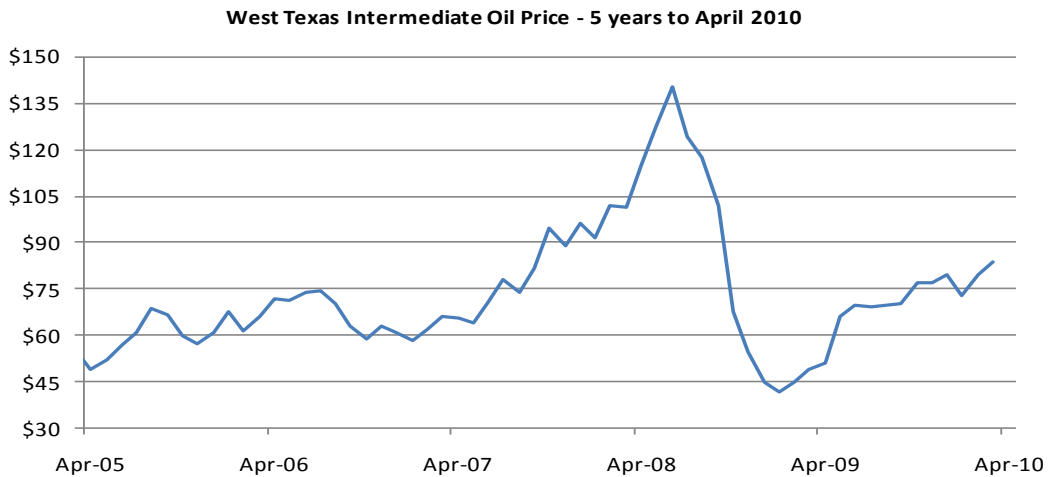


Source: Premium Data.
Series rebased: 30 April 2009 = 100

Oil prices higher

Oil prices were again higher in April, closing the month up 2.9% at US\$86.15 a barrel amid US dollar weakness, attacks on a Northern Iraqi oil pipeline and reports that global manufacturing is beginning to strengthen. This was more than enough to overshadow news that the Energy Information Administration had lowered its 2010 demand growth forecast by 10,000 barrels per day and increasing expectations that China will soon begin to raise interest rates.

After gaining 78% in 2009, oil prices have so far risen 8.6% in the first four months of 2010.



Source: Energy Information Administration

Bond yields mixed

Global bond yields¹ were mixed in April as the debt situation in Greece, Portugal and Spain weighed on European risk sentiment while elsewhere, i.e. the US and Australia, investors choose to focus on some better-than-expected economic data and earnings results.

In the US, the yield on 10-year bonds fell 18 basis points to close the month at 3.65% and it was a similar story here in Australia, with the yield on our 10-year bonds falling 4 basis points to close at 5.71%.

China's economy expands 11.9%

The Chinese economy expanded by 11.9% in the year to 31 March 2010, but whilst that sounds like a lot – and it is – the result was actually in line with the market's expectations. At the same time, though, the latest round of inflation data showed a modest decline in prices, which will present the country's central bank with something of a dilemma.

Given the extraordinary pace at which the economy is growing, the Bank will probably want to tighten up its monetary policy, i.e. raise interest rates, to help slow it down. However, with inflation not blowing out like many had expected it to, the timing of any interest rate hike will become a significant issue.

Interestingly, the last time China's growth accelerated by more than 11% – in the first quarter of 2006 – the central bank raised interest rates within a month.

¹ Bond yields have an inverse relationship with bond prices, meaning when yields fall, prices rise (and vice versa).

The Reserve Bank moves again

As was widely expected, the Reserve Bank of Australia (RBA) raised interest rates by a further 0.25% following its April Board meeting. The move took the official cash rate to 4.25% and marked the fifth rate rise in the past six meetings. However, the RBA's decision was hardly a surprise, given that Governor Glenn Stevens had earmarked a rate rise ahead of the Bank's meeting when he told Channel Seven that Australians "can't assume rates will remain low." By lifting the official cash rate, it's clear that the Bank remains concerned that inflation and rising house prices have the potential to spiral out of control without tighter monetary conditions.

The Bank has now added a full 1.25% to the official cash rate since October last year and the market is expecting another 0.25% increase following the RBA's upcoming May meeting. Banks use the official cash rate as a starting point when calculating standard variable rates.

Meanwhile, the US Federal Reserve (0-0.25%), the Bank of England (0.50%), the European Central Bank (1.00%) and the Bank of Japan (0.10%) all left their respective benchmark interest rates on hold during the month.

Australian share market closes lower

The Australian share market gave back some of last month's gains in April, with the S&P/ASX 200 Accumulation Index closing the month 1.4% lower. The fall came mainly on the back of renewed debt concerns in Europe, though expectations of higher interest rates both here and in China (which has the potential to hurt demand for our commodities) were also negatives.

The local market is now essentially flat (-0.04%) so far this year. This compares to +6.4% in the US, +4.8% in Japan, +2.6% in the UK and -5.0% in Europe.

S&P/ASX 200 Accumulation Index - Year to 30 April 2010



Source: Premium Data

Australian dollar stronger

The Australian dollar (A\$) made only a modest gain against the US dollar in April, up 0.8% on the back of stronger economic data and expectations of yet more interest rate hikes by the Reserve Bank. The local currency had hit a high of US\$0.9382 cents before risk aversion took hold following S&P's decision to cut Greece's credit rating to junk, prompting investors to trim their positions in 'growth-sensitive' currencies like the Aussie.

The A\$ is now up 54% against the US dollar since hitting a low of US\$0.6012 cents back in October 2008 and may yet hit parity with the US currency later this year should the differential between our interest rates and theirs continue to widen.

Australian dollar versus US dollar - Year to 30 April 2010



Source: Premium Data

Looking ahead

Despite a relatively mixed start to 2010, global share markets continue to sit well above the lows they hit back in March last year. Expectations are that shares will move even higher over the next 12 months, though that will depend on two things: company earnings and interest rates. Company share prices have rallied strongly since early March 2009, meaning that companies now need to step up to the plate and deliver strong earnings growth to justify the rally. Encouragingly, we've already begun to see this in the US and Europe, where companies have posted better-than-expected numbers for the March quarter. This should bode well for future gains and help maintain the recovery's momentum. On the other hand, interest rates look set to rise further in 2010 and that has the potential to dampen the recovery since it'll make the cost of borrowing money that little bit more expensive.

Here in Australia, the market and the economy continue to hold up relatively well when compared to many of their global counterparts. Further economic growth is expected over the remainder of 2010, supported in particular by a strengthening labour market and stronger growth in Asia, namely China.

In terms of interest rates, the RBA has made its intentions pretty clear. With growth no longer a major concern, the Bank's focus is now on inflation and the need to keep it under control; which will unfortunately mean further rate hikes throughout the year. Expectations are that the official cash rate will hit around 5.00% by year-end.

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